



CONGRESSIONAL BUDGET OFFICE MANDATES STATEMENT

May 22, 1998

H.R. 3849 **Internet Tax Freedom Act**

As ordered reported by the House Committee on Commerce on May 14, 1998

SUMMARY

H.R. 3849 contains no private-sector mandates, but by imposing a moratorium on certain types of state and local taxes, the bill would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act of 1995 (UMRA). For reasons described below, CBO cannot estimate whether the direct costs of this mandate would exceed the statutory threshold established in UMRA (\$50 million in 1996, indexed annually for inflation).

INTERGOVERNMENTAL MANDATES CONTAINED IN THE BILL

H.R. 3849 would impose a three-year moratorium on certain state and local taxes, including taxes on Internet access and online services. This moratorium would constitute an intergovernmental mandate as defined in UMRA. The bill would allow states that have already imposed a tax on these services to reinstate their taxes but only if they enact, within a year's time, a new law expressly imposing the taxes.

ESTIMATED DIRECT COSTS OF MANDATES TO STATE, LOCAL, AND TRIBAL GOVERNMENTS

Is the Statutory Threshold Exceeded?

Because it is unclear what should be counted as the direct costs of the mandate, CBO cannot determine whether the threshold for intergovernmental mandates would be exceeded in any of the three years of the moratorium.

Total Direct Costs of Mandates

UMRA defines the direct costs of an intergovernmental mandate as "the aggregate estimated amounts that all state, local, and tribal governments...would be prohibited from raising in revenues in order to comply with the federal intergovernmental mandate." There are several reasons why CBO is unsure how to measure the direct costs of the mandate in this bill, having to do either with ambiguities in UMRA or difficulty in interpreting the language of H.R. 3849. In particular:

- it is unclear whether giving states the opportunity to opt out of the moratorium effectively eliminates most of the cost of the mandate;
- it is unclear whether taxes assessed but not collected should be counted toward the direct costs of the mandate; and
- it is unclear how the moratorium would apply during the period of up to a year in which states can override it.

H.R. 3849 would exempt from the moratorium any taxes that were "generally imposed and actually enforced under state law before March 1, 1998." CBO has identified 12 states (including the District of Columbia) that sought to impose their sales and use taxes on Internet access and online services by that date. However, in order to take advantage of this grandfather clause, these 12 states would have to enact a law within a year that expressly subjects those services to taxation. The direct costs of the mandate could be limited to the administrative costs to enact new laws in the 12 states plus any tax revenues lost during the interim between the enactment of H.R. 3849 and the enactment of those state laws. However, any of these 12 states that failed to enact the necessary law within a year would incur additional costs because they would be precluded from imposing their taxes on these services for two more years.

CBO is unsure whether those additional forgone revenues should also be considered direct costs of the mandate, because we are uncertain how to measure the costs of a mandate that states can avoid by enacting a law. On the one hand, it could be argued that the 12 states would be able to choose whether or not to abide by the moratorium--and that the fiscal consequences of that choice would be the responsibility of the states, not of the federal government. On the other hand, in the absence of this bill, a state's failure to act would have no consequences. Under this bill, a state's failure to act would result in a restriction of its sovereign power to tax. It could be argued, therefore, that any loss of revenue should count as the costs of a mandate under UMRA.

Second, CBO cannot make a threshold determination because we are unsure whether the direct costs of the tax moratorium should be only actual collections forgone or whether tax liabilities that are being litigated should also be included. Information from states and

industry sources indicates that while total collections and unpaid assessments in 1997 were close to \$50 million, actual collections alone were significantly lower than that amount. The difference occurs because, in some of the states, companies are challenging the applicability of the tax to the service they provide or the state's finding that they are obliged to collect the tax on the state's behalf. In those cases, the companies are not collecting the tax, but they are accruing a potential tax liability to the states. CBO is unsure whether a tax that is being assessed but is not being paid should be counted toward the direct costs of a mandate when the applicability or constitutionality of the tax is being litigated.

The potential mandate cost would grow over the three years that the moratorium would be in effect, because of the projected growth of the market for Internet access and online services. Some industry analysts have predicted that the market will more than double in the next three years. Growth of this magnitude would push the states' collections plus potential tax liability over \$50 million, but whether actual collections would reach that threshold would depend on the outcome of litigation. If the states prevail in court, the mandate cost would exceed the threshold.

It is possible that, in the absence of this legislation, some state and local governments would enact new taxes or decide to apply existing taxes to Internet access or online services during the next three years. It is also possible that some governments would repeal existing taxes or preclude their application to these services. Such changes would affect the ultimate cost of the mandate but are extremely difficult to predict. Therefore, for the purposes of estimating the direct costs of the mandate in this bill, CBO considered only the revenues from taxes that are currently in place.

Finally, it is not clear from the language in H.R. 3849 whether each of the 12 states would be allowed to continue collecting its tax between the date of enactment of this bill and the date when it enacts a law reinstating its tax. Even if the 12 states were allowed to continue collecting their taxes during the first year of the moratorium, H.R. 3849 does not clearly indicate what would happen if any of those states did not manage to pass a law during the year. It is possible that any states failing to pass a law would be required to return any collections from the previous year. Because of these ambiguities, we cannot estimate whether these 12 states would forgo any revenues during the first year of the moratorium.

The moratorium in H.R. 3849 would also apply to "bit taxes," which are taxes based in some way on the volume of digital information being transmitted. According to both state officials and industry representatives, no state or locality has adopted this type of tax. The moratorium would also apply to "multiple or discriminatory taxes on electronic commerce." CBO could not identify any current state or local taxes that would clearly meet the definitions provided in the bill for these two types of taxes.

APPROPRIATION OR OTHER FEDERAL FINANCIAL ASSISTANCE PROVIDED IN BILL TO COVER MANDATE COSTS

None.

OTHER IMPACTS ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3849 would establish a process that could lead to a fundamental reform of state and local sales and use taxes as they apply to electronic commerce. The bill would establish an Advisory Commission on Electronic Commerce made up of federal officials, representatives of state and local governments, and representatives of taxpayers and businesses. The commission's duties would include writing proposed legislation to give states expanded authority to require the collection of sales and use taxes on electronic commerce if they simplify their tax codes. The proposed legislation would also have to provide that after four years, states that had not yet simplified their tax code would lose any authority to tax electronic commerce until they did so. This legislation would be submitted to the President, who would then have the choice of submitting some or all of it to the Congress. Any proposals submitted to the Congress would receive expedited consideration.

PREVIOUS CBO ESTIMATES

CBO has completed intergovernmental mandates statements for three other versions of the Internet Tax Freedom Act. Each version would impose a moratorium on some categories of state and local taxes. In each case, we determined that the moratorium would constitute an intergovernmental mandate as defined in UMRA. The direct costs that we estimated for the mandate in each bill differed depending on the scope and duration of the moratorium. For two bills, we determined that the costs of complying with the mandate would exceed the threshold established in UMRA. For the remaining bill, we were unable to determine whether the threshold was exceeded.

Date	Bill Number	Version	Threshold Determination
June 18, 1997	S. 442	As introduced	Threshold exceeded
January 21, 1998	S. 442	As ordered reported by full committee	Cannot determine
March 25, 1998	H.R. 1054	As approved by subcommittee	Threshold exceeded

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